

Message Text

SECRET

PAGE 01 OTTAWA 02423 01 OF 03 120054Z
ACTION EUR-12

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S E C R E T SECTION 01 OF 03 OTTAWA 02423

E.I. 11652: GDS
TAGS: ECON, CA
SUBJECT: CANADIAN DEFENSE SPENDING

REFS: A. DAO OTTAWA 1983, B. OTTAWA 2200, C. NATO 4139
D. OTTAWA 2279

1. SUMMARY. DND HAS PROVIDED US WITH CURRENT FIVE YEAR ESTIMATES, FY 1978 THRU FY 1982, FOR CANADIAN SPENDING ON NATIONAL DEFENSE ACCORDING TO NATO DEFINITIONS. DND ESTIMATE FOR REAL (INFLATION ADJUSTED) GROWTH IN FY 1979 (WHICH BEGAN APRIL 1) IS IN THE RANGE OF 1.4 TO 2.6 PERCENT. THE FIVE YEAR ANNUAL AVERAGE, FY 1978-82 IS FOR REAL GROWTH OF 2.8 TO 3.6 PERCENT. HOWEVER, BOTH ESTIMATES ARE SUBJECT TO REVISION EITHER UPWARD OR DOWNWARD. MORE REFINED ESTIMATES FOR CURRENT FISCAL YEAR WILL BE SUBMITTED TO NATO WITHIN NEXT MONTH. OFFICIALS STRESSED THAT ACTUAL TIMING OF EXISTING CANADIAN COMMITMENTS FOR REAL INCREASE (SUCH AS MANPOWER INCREASES AND SPENDING ON CAPITAL EQUIPMENT) IS STILL OPEN, AND MAY NOT ALL BE REALIZED IN FIVE YEAR PERIOD. ON CURRENT FORM, WE MUST REGARD CANADIAN CONFORMANCE TO DPC MINISTERIAL
SECRET

SECRET

PAGE 02 OTTAWA 02423 01 OF 03 120054Z

GUIDANCE AS ANYTHING BUT A SURE THING. IT IS THUS IMPORTANT TO KEEP WATCHING, AND TO MAKE SURE CANADIANS KNOW WE ARE WATCHING. END SUMMARY.

2. THE TWO DND ESTIMATES OF NOMINAL (CURRENT DOLLAR) DEFENSE EXPENDITURES AND PERCENT CHANGES IN REAL (INFLATION ADJUSTED) DEFENSE SPENDING SHOWN ON THE TABLE BELOW

ARE BASED ON NATO DEFINITIONS, NOT THE DND BUDGET ALONE. ESTIMATES OF NOMINAL EXPENDITURES ABOVE THOSE IN THE CURRENT DND BUDGET (SEE DAO OTTAWA 1983) INCLUDE UNDER NATO DEFINITION ITEMS SUCH AS NON-DND SPENDING BY COAST GUARD, PAYMENTS TO MUNICIPALITIES IN LIEU OF TAXES, AND WEATHER SERVICES.

3. THE TWO SCENARIOS IN THE TABLE BELOW SHOWING HIGHER AND LOWER RANGES OF NOMINAL AND REAL DEFENSE SPENDING GROWTH BOTH ASSUME APPROVAL BY GOC TREASURY BOARD (ROUGHLY EQUIVALENT TO OMB) OF THE PROGRAM REQUESTED BY DND BUDGET FOR FY 1980. DIFFERENCES BETWEEN THE TWO SETS OF ESTIMATES ARE DUE TO:

A. DIFFERENT ASSUMPTIONS REGARDING ACTUAL SPENDING IN FY 1978, (ENDED MARCH 31, 1978), ACTUAL SPENDING IN CURRENT FY 1979, AND (ROUGH) FORECASTS OF FUTURE YEARS (SEE BELOW).

B. DIFFERENT ASSUMPTION IN REGARD TO NOMINAL SPENDING (BUT NOT REAL GROWTH) DUE TO STATUTORY REQUIREMENTS OUTSIDE THE DIRECT DND PROGRAM FORECAST, SUCH AS ACTUARIAL ADJUSTMENTS FOR PENSION CONTRIBUTIONS.

C. DIFFERENT ASSUMPTIONS RE RATE OF EXPANSION OF AGREED PROGRAMS SUCH AS MANPOWER AND CAPITAL EQUIPMENT INCREASES (SEE PARA 5 BELOW).

SECRET

SECRET

PAGE 03 OTTAWA 02423 01 OF 03 120054Z

D. DIFFERENT ASSUMPTION RE RATE OF REAL GROWTH OF SPENDING BY GOVERNMENT DEPARTMENTS OTHER THAN DND ON NATO-DEFINED DEFENSE-RELATED ITEMS. (SEE PARA 6 BELOW).

4. NOTE THAT TREASURY BOARD HAS NOT YET APPROVED DND PROGRAM REQUEST FOR FY 1980, AND OF COURSE NOT IN CUR-

RRENT YEARS. ESTIMATES IN TABLE ARE THUS NOT HIGHEST OR LOWEST POSSIBLE ESTIMATES OF NOMINAL OR REAL CANADIAN DEFENSE SPENDING. EMBASSY BELIEVES UPPER ESTIMATE IS DECIDEDLY OPTIMISTIC.

5. CAPITAL SPENDING. A KEY VARIABLE IN THE HIGH AND LOW ESTIMATES IS SPENDING FOR NEW CAPITAL EQUIPMENT AND MANPOWER.

A. CAPITAL EQUIPMENT. DND HAS STATED IT WAS UNABLE TO SPEND CDOLS 60 MILLION IN CURRENT FISCAL YEAR (1979) AND DOLS 25 MILLION LAST FISCAL YEAR, BUT THAT IT HAS BEEN PROMISED BY THE TREASURY BOARD THAT IT WILL BE

ALLOWED TO RECOVER THIS DOLS 85 MILLION TOTAL, DULY
ADJUSTED FOR INFLATION, IN LATER FISCAL YEARS -- PRE-
SUMABLY OVER AND ABOVE WHATEVER (AMOUNT UNSPECIFIED) DND
WOULD HAVE RECEIVED OTHERWISE IN THAT PARTICULAR FISCAL
YEAR. DND OFFICIALS HAVE SUGGESTED THAT THIS CDOLS 85
MILLION MIGHT BE USEFUL IN FUTURE YEARS FOR PLANNED
ACQUISITION OF NEW FIGHTER AIRCRAFT. HOWEVER, DND
OFFICIALS HAVE TOLD US THERE IS NO RPT NO TIME COMMITMENT
FOR THE TREASURY BOARD AS TO WHEN THIS AMOUNT WILL BE
"RECOVERED". THE HIGH ESTIMATE IN THE TABLE IS BELIEVED
TO INCLUDE "RECOVERY" OF THE FULL CDOLS85 MILLION BY

SECRET

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SECRET

PAGE 01 OTTAWA 02423 02 OF 03 120102Z
ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 PM-05 INR-10 L-03 ACDA-12
NSAE-00 PA-01 SS-15 SP-02 ICA-11 TRSE-00 NSC-05
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S E C R E T SECTION 02 OF 03 OTTAWA 02423

FY 1982. HOWEVER, TREASURY BOARD PRESIDENT ANDRAS
CONFIRMS TO AMBASSADOR THAT GOC MINISTERIAL AGREEMENT
ON A TWELVE PERCENT PER YEAR INCREASE IN REAL SPENDING
ON CAPITAL EQUIPMENT UNTIL AT LEAST 20 PERCENT OF THE
BUDGET IS REACHED REMAINS IN EFFECT. GOC OFFICIALS
APPARENTLY REGARD THE GOAL OF A 12 PERCENT ANNUAL AVERAGE
GROWTH AS A TARGET TO BE REACHED OVER SEVERAL YEARS, AND
DO NOT FEEL OBLIGED TO MAINTAIN THIS GROWTH RATE IN ANY
PARTICULAR FISCAL YEAR. (DND OFFICIALS COMMENTED TO US
INFORMALLY THEY BELIEVED CAPITAL SPENDING SHOULD RISE TO
25 OR 30 PERCENT OF THE BUDGET, NOT JUST 20 PERCENT.)

B. MANPOWER. GOC HAS AGREED TO INCREASE DND MANPOWER
BY 5,000 MAN YEARS, BUT THE TIME PERIOD OVER WHICH THAT
INCREASE IS TO TAKE PLACE HAS NOT BEEN SPECIFIED. THE
UPPER ESTIMATE OF "REAL" DEFENSE GROWTH IN THE TABLE
ASSUMES MOST IF NOT ALL OF THIS MANPOWER WILL BE ADDED

BETWEEN NOW AND FY 1982, BUT DND OFFICIAL CONFIDED THAT THIS IS PROBABLY AN UNREASONABLE ASSUMPTION. ABOUT 950 MAN YEARS ARE ASSUMED TO BE ADDED DURING FY 1979, BUT THIS GOAL MAY NOT BE MET EITHER.

SECRET

SECRET

PAGE 02 OTTAWA 02423 02 OF 03 120102Z

6. THE HIGH ESTIMATE IN THE TABLE ASSUMES A 3 PERCENT PER YEAR REAL INCREASE IN DEFENSE EQUIPMENT AND SERVICES PROVIDED THRU FY 1982 BY DEPARTMENTS OTHER THAN DND. DND OFFICIALS SAY (AND WE AGREE) THIS IS PROBABLY TOO OPTIMISTIC. THE LOW ESTIMATE ASSUMES NO REAL INCREASE IN DEFENSE SPENDING BY NON-DND AGENCIES.

7. IN CALCULATING INCREASES IN REAL DEFENSE SPENDING, DND PROCEDURE IS TO CONSTRUCT SEPARATE PRICE INDICES FOR SEVERAL COMPONENTS OF THE BUDGET, WEIGHT THEM BY THEIR RELATIVE CONTRIBUTION TO DEFENSE EXPENDITURES TO PRODUCE AN AGGREGATE INFLATION FACTOR, AND THEN TO DEFLATE NOMINAL SPENDING BY THIS AMOUNT. AGGREGATE INFLATION FACTORS HAVE BEEN AFFECTED IN THE PAST BY "CATCH UP" PAYMENTS BY DND INTO PENSION ACCOUNTS TO MAKE UP FOR PAST SHORTFALLS. THESE CATCH UP PAYMENTS ARE TREATED AS ENTIRELY DUE TO INFLATION. CATCH UP PAYMENTS WERE INCLUDED IN THE PAST SEVERAL FISCAL YEARS, BUT NOT IN ESTIMATES FOR FY 1979 OR ONWARDS. ANY FUTURE CATCH UP PAYMENTS WOULD THUS INCREASE NOMINAL DND SPENDING AND THE INFLATION FACTOR, BUT WOULD NOT INCREASE "REAL" DEFENSE SPENDING. THIS ELEMENT IN THE INFLATION FACTOR IS NOT INCLUDED IN FY 1979-82, AND THE INFLATION ADJUSTMENT FOR ESTIMATES IN THOSE YEARS IS CONSEQUENTLY LESS THAN IT WOULD BE OTHERWISE.

8. CONCLUSIONS.

A. TOTAL SPENDING. TOTAL CANADIAN DEFENSE SPENDING (NATO DEFINITIONS, AS INTERPRETED BY GOC) WILL NOT MEET THE NATO GOAL OF A THREE PERCENT REAL INCREASE IN FY 1979. WHETHER IT WILL AVERAGE THREE PERCENT OR MORE IN THE THREE YEARS FY 1980-82 CANNOT NOW BE DETERMINED WITH MUCH CONFIDENCE.

SECRET

SECRET

PAGE 03 OTTAWA 02423 02 OF 03 120102Z

B. CAPITAL SPENDING. THE EXISTING AGREEMENT SEEMS PROBLEMATICAL BETWEEN DND AND THE TREASURY BOARD FOR THE "RECOVERY" IN LATER FISCAL YEARS OF THE 85 MILLION DOLLARS NOT SPENT BY DND ON CAPITAL ITEMS IN FY 1977-78 AND 1978-79.

SUCH RECOVERY IMPLIES ADDITIONAL SPENDING ABOVE AND BEYOND
WHATEVER BASE WOULD HAVE BEEN SPENT ON CAPITAL GOODS IN ANY
CASE, A BASE WHICH IS CLEARLY SUBJECT TO UNCERTAINTY. IN
PRACTICE THE AMOUNT "RECOVERED" MAY WELL SIMPLY BE IDENTI-
FIED AS HAVING BEEN SPENT DURING THOSE YEARS WHEN PLANNED
NEW FIGHTER AIRCRAFT ACQUISITIONS ARE MADE.

9. TABLE. DND ESTIMATES OF DEFENSE SPENDING (NATO DEFINI-
TION) MILLIONS OF NOMINAL (CURRENT) CANADIAN DOLLARS AND
PERCENT CHANGE OF REAL (INFLATION ADJUSTED) SPENDING, FIVE
FISCAL YEARS 1977-78 TO 1981-82 AND FIVE YEAR ANNUAL AVERAGE.

-----1977-	1978-	1979-	1980-	1981-	
-----1978	1979	1980	1981	1982	AVG.

I. LOWER

ESTIMATE:

NOMINAL

SPENDING

(CDOLS) 4,221.0 4,414.8 5,120.3 5,497.2 6,018.1 -

REAL SPENDING

(PERCENT) 3.33 1.42 4.78 1.29 3.21 2.81

II. HIGHER

ESTIMATE:

NOMINAL SPENDING

(CDOLS) 4,236.2 4,683.3 5,195.0 5,690.8 6,270.7 -

REAL SPENDING

SECRET

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SECRET

PAGE 01 OTTAWA 02423 03 OF 03 120102Z

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USMISSION USNATO

USCINCEUR VAIHINGEN GE

S E C R E T SECTION 03 OF 03 OTTAWA 02423

(PERCENT) 3.69 2.55 4.76 3.34 3.88 3.64

III DND BUDGET:

NOMINAL SPENDING

(CDOLS) 3,798 4,129 ENDERS

SECRET

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